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**MARYLAND HEALTH CARE COMMISSION**

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**MEMORANDUM**

**TO:** Commissioners

**FROM:** Kevin R. McDonald  
Chief, Certificate of Need 

**DATE:** November 20, 2014

**SUBJECT:** Ashley, Inc., d/b/a Father Martin's Ashley - Docket No. 13-12-2340

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Enclosed is the staff report and recommendation on the request by Father Martin's Ashley ("FMA") for a Project Change after CON Approval ("modification request") for the above-referenced project initially approved by the Commission in September 2013 for a total project cost of \$18,653,000.

FMA has requested authorization to increase the total project costs by \$2.275 million, bringing the projected total project costs to \$20,928,056. FMA identified the main driver of the cost increase as higher-than-anticipated costs for meeting State and County regulations for waste water treatment and septic field requirements. The total anticipated cost increase of \$2,275,056 (12.2%), exceeds the permissible inflation allowance. All of the additional cost is proposed to be covered by increased borrowing.

Staff has reviewed the request for the cost increase and believes that the requested modification does not change the Commission's earlier findings regarding need, viability, cost effectiveness, or impact on other providers, and thus recommends **APPROVAL** of the modification request.

IN THE MATTER OF

ASHLEY, INC., d/b/a

FATHER MARTIN'S ASHLEY

DOCKET NO. 13-12-2340

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BEFORE THE

MARYLAND

HEALTH CARE

COMMISSION

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## REQUEST TO MODIFY CERTIFICATE OF NEED

### I. INTRODUCTION

#### Background

In September 2013, the Maryland Health Care Commission ("Commission" or "MHCC") granted a Certificate of Need ("CON") to Ashley, Inc. d/b/a Father Martin's Ashley ("FMA") to construct a two-story building on its campus in Havre de Grace in Harford County. The new 4,824 square foot building will replace 21 existing Intermediate Care Facility-Chemical Dependency ("ICF-CD") beds and add 15 new beds, increasing FMA's total capacity from 85 to 100 ICF-CD beds.

The original total approved project cost was \$18,653,000, comprised of \$18,361,000 in total capital costs and \$292,000 in loan placement, legal, and consultant fees. The sources of funds included \$6 million in cash, \$7 million in borrowing, and the remainder via philanthropy (\$1,653,000 in gifts and bequests in hand and \$4 million in pledges).

The CON was approved with three conditions:

- 1. Father Martin's Ashley shall commence reporting data and other required information to the Alcohol and Drug Abuse Administration's Substance Abuse Management Information System (SAMIS) program within six months of this approval and first use approval shall not be granted until FMA submits documentation of such reporting.*
- 2. Father Martin's Ashley shall provide a minimum of 6.3% of patient days of care to indigent and gray area patients, as defined in the State Health Plan, commencing with the first full year of operation following completion of the approved project. Father Martin's Ashley shall document the provision of such charity care by submitting annual reports auditing its total days of care and the provision of days of care to indigent and gray area patients as a percentage of total days of care. Such audit reports shall be submitted to the Maryland Health Care Commission following the first full year of operation following completion of the approved project and continuing for five years thereafter.*

3. *At the end of the fifth year of full operation following completion of the approved project, FMA will provide a report to MHCC on its program effectiveness using measures, drawn from recognized organizations that develop and promote the use of quality and performance measures or from other sources, that are approved by MHCC staff prior to the grant of first use approval. The evaluation of program effectiveness shall include, at a minimum, evaluation of treatment success through follow-up of discharged patients and collaborative efforts with similar treatment programs in other states to institute standardized peer review for study and improvement of program effectiveness.*

### **Modification Request**

FMA has requested authorization to increase the total project costs by \$2.275 million, bringing the total project costs to \$20,928,056. The applicant identified the main driver of the cost increase as higher than anticipated cost for meeting State and Harford County regulations for waste water treatment and septic field requirements. Details of the cost increase will be provided later in this report. The total anticipated cost increase of \$2,275,056 (12.2%), exceeds the permissible inflation allowance. All of the additional cost is proposed to be covered by increased borrowing.

FMA reports progress in implementing:

- The project FMA's Quarterly Report covering the three months ending September 19, 2014 shows that it signed a binding construction contract on June 20 with construction on the new building commencing on August 15<sup>th</sup>. FMA expects to finish construction by October 15, 2015, on schedule to meet the performance requirement that the approved project be completed no later than 24 months after the effective date of the binding construction contract.
- As required in the first condition, FMA began reporting data to the Alcohol and Drug Abuse Administration's Substance Abuse Management Information System (SAMIS) program beginning with patients admitted on April 1, 2014.
- With regard to the third condition requiring systematic evaluation of program effectiveness, FMA reports progress towards establishment of an arrangement with the Johns Hopkins University School of Medicine to develop a methodology that will accomplish this end.

## **II. APPLICABLE REGULATIONS**

Under the Commission's regulations, at COMAR 10.24.01.17B, the following changes to an approved CON require the Commission's approval:

1. *A significant change in physical plant design;*
2. *Capital Cost increases that exceed the approved capital cost inflated by an amount determined by applying the Building Cost Index published in Healthcare Cost Review from the application submission date to the date of the filing of a request for approval of a project change;*

3. *When total projected operating expenses or revenue increases exceed the projected expenses or revenues in the approved Certificate of Need Application, inflated by 10 percent per year;*
4. *Changing the financing mechanisms of the project; or*
5. *Changing the location or address of the project.*

FMA's request to modify its CON for this project is triggered by a capital cost increase that exceeds the approved capital cost inflated by an amount determined by applying the Building Cost Indices published in *Healthcare Cost Review* (COMAR 10.24.01.17B(2)) from the date that FMA initially submitted its CON application (January 25, 2013) to the date it filed the request for approval of the project change (September 22, 2014).<sup>1</sup> Accordingly, this request must be reviewed and approved by the Commission. *Healthcare Cost Review* is a quarterly publication of IHS.

The actions available to the Commission are found in **COMAR 10.24.01.17D(3)**:

*The Commission shall provide written notification to the applicant within 45 days of the Commission's receipt of the change request that:*

- (a) The proposed change is approved and is incorporated into a modified Certificate of Need for the project;*
- (b) The proposed change is approved in part or approved with conditions;*
- (c) The proposed change is not approved, with explanation; or*
- (d) The proposed change is of sufficient scope to warrant complete review in accordance with the Certificate of Need review process described in Regulations .08—.10 of this chapter, and may only be considered upon completion of this review.*

### **III. COST INCREASES AND FINANCIAL IMPACT OF THE PROPOSED MODIFICATION**

#### **CON-approved cost compared to modification request**

FMA described and explained the cost increases as follows:

- **Construction costs:** To comply with State and Harford County regulatory requirements for waste water treatment expansion, additional septic field requirements for the site, and additional regulatory requirements for building permits, FMA will incur additional costs related to the re-design and building of a new wastewater treatment plant that meets all environmental standards. This will increase

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<sup>1</sup> FMA's request to modify the CON does not involve any significant change in physical plant design, an increase in operating expense or revenue, or a change in either financing or location of the project.

construction costs by \$1,198,609 (an 11.1% increase in the estimate of construction cost approved).

- **Site preparation:** The increase in this cost is attributed to an increase in the scope for storm water management, septic trench system expansion, and the abandonment of the existing septic fields on the FMA campus, increasing the cost for preparing the site by \$706,281 (18.1%).
- **Architectural & Engineering Fees:** The project will incur about \$310,000 in additional costs (29.8%) associated with the performance of on-going well monitoring, the re-design of the pre-treatment plant, and additional inspections required by the Maryland Department of the Environment.
- **Permits:** The cost of permits increased by \$20,000 to \$115,000 (21.1%).
- **Construction of a temporary road** to accommodate offsite excavation material hauling, which was not anticipated in the original plan for this project, is estimated to cost \$40,166.

Table 1 below displays the projected cost estimates as originally approved by the Commission with the new estimated costs submitted by FMA in its modification request. It also shows in the "sources" section that the entirety of the increased cost is proposed to be covered by increased borrowing.

<b>A. Uses of Funds</b>				
	<b>CON Approved Costs</b>	<b>2014 Current Cost Estimate</b>	<b>Cost Increase</b>	<b>% Change</b>
<b>New Construction</b>				
Building	\$10,750,000	\$11,948,609	\$1,198,609	11.1%
Site Preparation	3,900,000	4,606,281	706,281	18.1%
Architect/Engineering Fees	1,042,000	1,352,000	310,000	29.8%
Permits	95,000	115,000	20,000	21.1%
<b>Subtotal-New Construction Costs</b>	<b>\$ 15,787,000</b>	<b>\$ 18,021,890</b>	<b>\$ 2,234,890</b>	<b>14.2%</b>
<b>Other Capital Costs</b>				
Minor Movable Equipment	\$525,000	\$550,000	\$25,000	4.8%
Other Equipment				
Wellness/Fitness Center Equipment	200,000	90,000	(110,000)	-55.0%
Telecommunications Equipment	60,000	60,000	-	0.0%
Information Technology	100,000	200,000	100,000	100.0%
Miscellaneous, e.g., Security System	350,000	250,000	(100,000)	-28.6%
Subtotal	1,235,000	1,150,000	(85,000)	-6.9%
Contingencies	962,000	962,000	-	0.0%
Subtotal-Other Capital Costs	2,197,000	2,112,000	(85,000)	-3.9%
<b>Sub-Total Current Capital Costs</b>	<b>\$17,984,000</b>	<b>\$20,133,890</b>	<b>\$ 2,149,890</b>	<b>12.0%</b>
Inflation	\$377,000	\$168,670	(\$208,330)	-55.3%
<b>Total Capital Costs</b>	<b>\$ 18,361,000</b>	<b>\$ 20,302,560</b>	<b>\$ 1,941,560</b>	<b>10.6%</b>

<b>Financing and Other Cash Requirements</b>				
Loan Placement Fee	\$237,000	\$0	(\$237,000)	-100.0%
Legal Fees	35,000	200,000	165,000	471.4%
Bank Fees	20,000	425,496	405,496	2027.5%
<b>Subtotal</b>	<b>292,000</b>	<b>625,496</b>	<b>333,496</b>	<b>114.2%</b>
<b>TOTAL USES OF FUNDS</b>	<b>\$ 18,653,000</b>	<b>\$ 20,928,056</b>	<b>\$ 2,275,056</b>	<b>12.2%</b>
<b>B Sources of Funds</b>				
	CON Approved Source	2014 Source of Funds	Change	% Change
Cash	\$6,000,000	\$6,000,000	-	0.0%
Pledges	4,000,000	4,000,000	-	0.0%
Gifts	1,653,000	1,653,000	-	0.0%
Mortgage	7,000,000	9,275,056	2,275,056	32.5%
<b>TOTAL SOURCES OF FUNDS</b>	<b>\$ 18,653,000</b>	<b>\$ 20,928,056</b>	<b>\$ 2,275,056</b>	<b>12.2%</b>

The source of funds for the additional \$2,275,056 will come from an extension of the PNC Bank line of credit.

### **Inflation allowance**

Capital cost increases that exceed the inflation allowance calculated using the building cost indices published on a quarterly basis by IHS in *Healthcare Cost Review* require Commission approval under COMAR 10.24.01.17B(2). Inflation is figured from the CON application's submission date (January 25, 2013 or the 1<sup>st</sup> quarter of CY 2013) to the date of the filing of the request for CON modification (September 22, 2014 – or the 3rd quarter of CY 2014). The allowable inflated capital cost is **\$17,984,000<sup>2</sup>**, i.e., an allowable inflation amount of **\$401,789** over the originally-approved capital cost.

The projected cost increase of **nearly \$2.3 million** clearly exceeds the allowable inflation level and therefore, requires the Commission's review and approval.

### **Impact on operating cost and revenue**

In its original application approved in September 2013 FMA projected that the proposed facility would reach profitability by the second full year of operation after project completion (FY 2017). As revised with this modification, that picture changes. Instead of a net profit of \$21,000 there would be a net loss of \$119,000 at the second full year of operation. With occupancy in FY 2017 projected to reach full capacity at around 95% and no projected change in operating revenue, FMA now states that it will thus rely on its non-operating income from investments -- about \$1,630,000 annually -- to offset the shortfall in operating income.

<sup>2</sup> Using the Building Cost Indexes reported in the MHCC's September 18, 2014 edition of the "Increase in the Cost of Approved Project Requiring Commission Approval."

## IV. ANALYSIS AND RECOMMENDATION

### **Impermissible Modifications**

The Commission's regulations identify certain circumstances where a modification is not permissible and the applicant requires a new Certificate of Need. COMAR 10.24.01.17C provides:

1. *Changes in the fundamental nature of a facility or the services to be provided in the facility from those that were approved by the Commission;*
2. *Increases in the total licensed bed capacity of medical service categories from those approved;*
3. *Any change that requires an extension of time to meet the applicable performance requirements specified under Regulation .12 of this chapter, except as permitted under Regulation .12E of this chapter.*

None of these circumstances apply in this case: the modification will not change the fundamental nature of the project or the services provided by this replacement; the total number of beds will remain the same as previously approved; and the applicant has not requested and does not anticipate a need for an extension of time to meet the applicable performance requirements. Therefore, the modification requested by Ashley, Inc. is permissible under COMAR10.24.01.17C.

### **Staff Findings**

Although the increase in the total project cost is significant (about 12.2%), the proposed modification will not have a material effect on the findings made by the Commission on September 19, 2013 with respect to the cost and effectiveness of alternatives or project viability. Because there are no material changes occurring either in the location, capacity, or nature of the project, the requested modification does not change the need for the project or its impact on existing providers.

The modification by FMA does not propose a change in the bed capacity of the project (100 ICF-CD beds). The proposed campus expansion will involve construction of a two-story building that will house 21 replacement beds and also include the addition of 15 beds, as reviewed and approved by the Commission in September 2013.

While the additional costs for completion of this project will have an impact on the financial viability of Father Martin's Ashley, the applicant has demonstrated that non-operating income will offset the projected increase in operating expenses and corresponding deficit in net operating income. Financial and non-financial resources necessary to implement and sustain the project continue to be available.

Staff recommends that the Commission **APPROVE** the proposed modification to the Certificate of Need issued to Ashley, Inc. d/b/a Father Martin's Ashley to construct a new two-story building that will house 21 existing and 15 additional ICF-CD beds awarded by MHCC (Docket No. 13-12-2340), with the following three conditions that were attached to the 2013 CON:

1. *Father Martin's Ashley shall commence reporting data and other required information to the Alcohol and Drug Abuse Administration's Substance Abuse Management Information System (SAMIS) program within six months of this approval and first use approval shall not be granted until FMA submits documentation of such reporting.*
2. *Father Martin's Ashley shall provide a minimum of 6.3% of patient days of care to indigent and gray area patients, as defined in the State Health Plan, commencing with the first full year of operation following completion of the approved project. Father Martin's Ashley shall document the provision of such charity care by submitting annual reports auditing its total days of care and the provision of days of care to indigent and gray area patients as a percentage of total days of care. Such audit reports shall be submitted to the Maryland Health Care Commission following the first full year of operation following completion of the approved project and continuing for five years thereafter.*
3. *At the end of the fifth year of full operation following completion of the approved project, FMA will provide a report to MHCC on its program effectiveness using measures, drawn from recognized organizations that develop and promote the use of quality and performance measures or from other sources, that are approved by MHCC staff prior to the grant of first use approval. The evaluation of program effectiveness shall include, at a minimum, evaluation of treatment success through follow-up of discharged patients and collaborative efforts with similar treatment programs in other states to institute standardized peer review for study and improvement of program effectiveness.*

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DOCKET NO. 13-12-2340

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BEFORE THE

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### FINAL ORDER

Based on Commission Staff's analysis and findings, it is this 20<sup>th</sup> day of November, 2014, **ORDERED** that:

The request for modification of an approved Certificate of Need issued to Ashley, Inc. d/b/a Father Martin's Ashley, to construct a new two-story building for 36 ICF-CD beds (which includes 21 existing and 15 additional ICF-CD beds) in Havre de Grace, Harford County, Docket No. 13-12-2340, at an estimated cost of \$20,928,056, is **APPROVED**, with the original three conditions continuing in effect:

1. *Father Martin's Ashley shall commence reporting data and other required information to the Alcohol and Drug Abuse Administration's Substance Abuse Management Information System (SAMIS) program within six months of this approval and first use approval shall not be granted until FMA submits documentation of such reporting.*
2. *Father Martin's Ashley shall provide a minimum of 6.3% of patient days of care to indigent and gray area patients, as defined in the State Health Plan, commencing with the first full year of operation following completion of the approved project. Father Martin's Ashley shall document the provision of such charity care by submitting annual reports auditing its total days of care and the provision of days of care to indigent and gray area patients as a percentage of total days of care. Such audit reports shall be submitted to the Maryland Health Care Commission following the first full year of operation following completion of the approved project and continuing for five years thereafter.*
3. *At the end of the fifth year of full operation following completion of the approved project, FMA will provide a report to MHCC on its program effectiveness using measures, drawn from recognized organizations that develop and promote the use of quality and performance measures or from other sources, that are approved by MHCC staff prior to the grant of first use approval. The evaluation of program effectiveness shall include, at a minimum, evaluation of treatment success through follow-up of discharged patients and collaborative efforts with similar treatment programs in other states to institute standardized peer review for study and improvement of program effectiveness.*

MARYLAND HEALTH CARE COMMISSION  
November 20, 2014